

First Supplement to Memorandum 96-43

Homestead Exemption: SB 197

Attached to this supplement are two letters concerning the homestead exemption bill and a copy of the latest amended version of SB 197 (for Commissioners):

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| | <i>pp.</i> |
| 1. Ronald H. Sargis, Hefner, Stark & Marois, Sacramento (June 3, 1996) . . . | 1 |
| 2. Gina L. Ebling, Analyst, State Department of Consumer Affairs
(June 12, 1996) | 5 |
| 3. SB 197 (Kopp), as amended in Assembly June 10, 1996 | |

Ron Sargis presents a thorough and detailed analysis of the declared homestead statute from the perspective of the California Association of Collectors. (See Exhibit pp. 1-4.) The staff does not agree on all points in his analysis, but in light of the confusing, incomplete, and contradictory language in the homestead exemption statutes, he presents a fairly plausible reading of the statute and we appreciate his work. The main points of disagreement have to do with (1) the actual point in time when a judgment lien attaches to a dwelling, since this depends on a valuation of the property and a determinations of senior liens and the applicable amount of the exemption, and (2) the related issue of whether a later-recorded homestead declaration can operate to protect proceeds of a voluntary sale.

The memorandum from Gina Ebling indicates that the State Department of Consumer Affairs is generally favorable toward the bill. (See Exhibit pp. 5-6.) We have discussed the points SDCA raises and believe, as to the first two points, that we have satisfied their concerns within the bill as amended. The third point, concerning use of a private escrow arrangement to hold the proceeds of a sale is a good suggestion, and we would add language in the Comment to Section 704.720(e) giving this as an example of how the parties might otherwise agree to deal with the proceeds, as permitted in the introductory clause of subdivision (e). (See SB 197, page 5, line 21.)

The fourth point raised by SDCA is appealing from a consumer protection standpoint — permitting the court to extend the six-month exemption period for

good cause on application of the debtor. The approach of the Commission's recommendation, consistent with the comments from the California Land Title Association and from the Legal Services Section of the State Bar, has been to continue the existing protection (and make it meaningful) in the automatic homestead exemption scheme. Existing law provides a six-month exemption period. At this point, the staff would not recommend taking any additional amendments that tip the balance toward debtors.

Respectfully submitted,

Stan Ulrich
Assistant Executive Secretary

Law Revision Commission
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JUN 07 1996

File: SB 197

June 3, 1996



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Re: **SB 197--Homestead Exemptions**

Dear Stan:

Following our last meeting, and in preparation for the recent CAC conference, I re-reviewed the commission reports and my earlier notes. I also took some time to sit back and consider the current Code of Civil Procedure sections and cases interpreting the application of the declared homestead. Based upon this review, I have reached the following conclusion:

1. If a declaration of homestead is recorded prior to the abstract of judgment, the judgment lien attaches to the property only to the extent that the value is in excess of the homestead exemption and all senior liens. As we discussed, the homestead law does not specify if the lien attaches/expands based upon time of recordation priority as the value of the homestead increases. Given the general provision that a recorded abstract attaches to subsequently acquired property in the order of recordation priority, it is logical that the abstract would attach/expand to the appreciation of a homestead in the same manner.

2. If the judgment lien is filed first, the subsequent recordation of a homestead declaration cannot limit or alter the judgment creditor's lien rights. In such a case, the debtor's homestead exemption is treated under the automatic provisions for purposes of that judgment lien creditor that was prior in time.

3. The proceeds from voluntary sale provisions relating to a declared homestead is not a lien issue and does not grant the judgment debtor any special power or ability to sell the property around a judgment lien that has attached to the homestead property. Further, the proceeds are exempt only to the extent that the judgment debtor actually uses them to purchase a replacement homestead within 6 months.

DISCUSSION OF RELEVANT LAW

For the convenience of your review on these points I want to discuss the specific underlying law. As we have identified, there were two homestead provisions under California law. The first is the automatic provision found in Code of Civil Procedure

Sections 704.710-704.850. These sections specify the dollar amount of the homestead exemption, what the creditor must do to sell homestead property, and how the proceeds from the sale are disbursed. These provisions apply whenever the judgment lien creditor goes to sell the homestead property, irrespective of whether it was an automatic or declared homestead.

Code of Civil Procedure Sections 704.910-704.995 are the additional provisions pertaining to declared homesteads. The California District Court of Appeal in the 1992 case of Reddy v. Gonzalez, 8 Cal.App.4th 118 (1992), briefly discussed the history of the declared homestead exemption. That court found, based upon the legislative committee comments to Code of Civil Procedure Section 704.910, that the declared homestead was retained as an alternative so as to continue the rule under former law that a judgment lien does not attach the declared homestead. However, the judgment lien can attach to any real property used as a dwelling, even if it is subsequently found to be subject to the automatic or declared homestead exemption. In such a case, the property is sold pursuant to the general homestead exemption provisions. Code of Civil Procedure Sections 704.710-704.850.

Under the declared homestead provisions, the specific method and manner of recording a homestead declaration is provided. Code of Civil Procedure Section 704.950 expressly modifies the general rule that a judgment lien attaches to all real property. This section provides in paragraph "(a)" that the judgment lien will not attach to it declared homestead if both the following requirements are satisfied:

- (1) A homestead declaration describing the declared homestead was recorded prior to the time the abstract or certified copy of the judgment was recorded to create the judgment lien, and
- (2) The homestead declaration names the judgment debtor or the spouse of the judgment debtor as a declared homestead owner.

This section expressly provides that the judgment debtor must record the declaration of homestead prior to the recording of the abstract in order to obtain the main benefit of a declared homestead, non-attachment of judgment lien. As noted in Miller & Starr, Current Law of California Real Estate, 2d Edition, the prior recording judgment creditor has priority over the declared homestead. Section 13:23, fn. 56. A prior recorded judgment lien is unaffected by the subsequent homestead declaration. Miller & Starr, 2d edition, Section 31:51.

Paragraph (c) of Section 704.950 expressly provides that the judgment lien will attach to a declared homestead that is effective under paragraph (a), to the extent that the value of the property exceeds the total of all of the liens and encumbrances and the homestead exemption for the property. While this may raise a factual question as to the

value of the property and the amount of the liens and encumbrances, it is not inconsistent with the purpose of the homestead exemption -- preventing a judgment creditor from selling a homestead without paying the debtor the homestead exemption.

As provided under C.C.P. Section 697.340(b), the judgment lien attaches to subsequently acquired property at the time it is acquired. If there are multiple judgment liens, priority is determined under C.C.P. Section 697.380, with order of attachment being determined by order of priority in creation--i.e., the first recorded having senior priority. See, C.C.P. Section 697.310 providing that a judgment lien is "created" by recording the abstract.

Code of Civil Procedure Section 704.960 provides an exemption for proceeds from the voluntary sale of a declared homestead. This section does not address the attachment or removal of any judgment liens against the declared homestead property, instead it relates to existing proceeds that the debtor may be holding. If a declared homestead is voluntarily sold, the judgment debtor may preserve the proceeds as exempt for six months from the date of sale. Then, if during the six month period the debtor re-invests the proceeds in a new dwelling, the homestead declaration on the new property will relate back to the record date of the original homestead declaration.

However, this section does not grant the judgment debtor the right to sell the property in contravention of judgment liens that have attached to the property. Further, it does not address the attaching of the lien to the homestead itself. Instead, it merely provides that if the debtor is able to sell the property, then he or she has six months to reinvest the property in a new dwelling free from creditors executing on the money while it was sitting in the escrow or bank. It must be remembered that the judgment liens cannot attach to the homestead property to the extent of the exemption. The section does not provide for removing any liens that attach or impairing an existing judgment creditor's lien rights.

I also note that the Ninth Circuit Court of Appeals determined that a condition of the declared homestead proceeds exemption is that the proceeds be reinvested in a homestead within 6 months. In re Golden, 789 F.2d 698, 699 (9th Cir. 1986). The court cited to the earlier California Supreme Court decision of Thorsby v. Babcock, 32 C.2d 202, which held that the declared homestead exemption was not intended to allow a debtor to withdraw sales proceeds from the reach of creditors unless the proceeds were invested in another homestead. Therefore, even under current law, if the judgment debtor is attempting to hold the proceeds as exempt, it must be for the purpose of a replacement homestead. A judgment debtor cannot withhold \$50,000-\$100,000 from bona fide claims of creditors merely by recording a homestead declaration.

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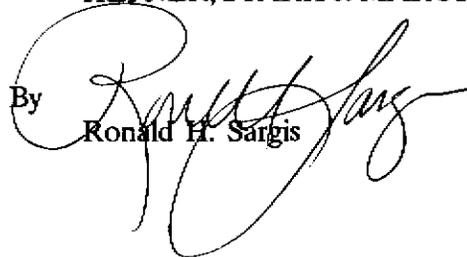
At this point, I have to disagree with the conclusions you have drawn with respect to a declared homestead recorded subsequent to a judgment lien. I do not think that a judgment debtor, against whose property judgment liens have been previously recorded, may subsequently record a declared homestead and then assert that the property can be sold free and clear of the lien. The proceeds exemption does not so provide, and 704.950 is equally clear that the judgment lien has attached to the property notwithstanding the subsequent recordation of the homestead declaration.

The sale provisions of Code of Civil Procedure Section 704.730 et seq. (automatic homestead) are not inconsistent with the declared homestead provisions. The sale procedures apply to a creditor selling a homestead property, irrespective of whether it is declared or automatic. The declared homestead does not give the judgment debtor any greater amount in value for a homestead exemption. Additionally, the declared homestead does not give the judgement debtor the right to strip off prior in time judgment liens or otherwise transfer the homestead around judgment liens that have attached.

Given the general rules of statutory construction, I believe that the existing declared and automatic homestead provisions can be interpreted in an internally consistent manner. The Legislature has been clear through the various homestead exemptions that the purpose, as specified in the California Constitution, is to protect the homestead value from sale by a judgment creditor unless the homestead exemption can be paid to the debtor. Giving all judgment debtors the right to freely sell homestead property without obtaining a consensual release of the judgment lien creates a series of problems for judgment creditors and will lead to further litigation, not less. The proposed legislation does not "correct" a problem, but instead would just upset the well established procedure and practice of debtor/creditor rights in California.

Very truly yours,

HEFNER, STARK & MAROIS, LLP

By 
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:RHS

cc: Bob Wilson, Esq.
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STATE OF CALIFORNIA
DEPARTMENT OF CONSUMER AFFAIRS

MEMORANDUM

Law Revision Commission
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JUN 12 1996

File: _____

DATE: JUNE 12, 1996

TO: Stan Ulrich
Law Revision Commission

Dan Friedlander, Consultant for
Senator Quentin Kopp

FROM: Gina L. Ebling, Analyst
State Department of Consumer Affairs

SUBJECT: SB 197

Department of Consumer Affairs Legal Counsel has reviewed the April 25, 1996 version of Senate Bill 197 and has found it to be a positive consumer protection bill. He has suggested the attached amendments to that version of the bill. I realize the bill has been amended since that date, therefore I have written page numbers from the June 10, 1996 version in the margins.

Please contact me as soon as possible with your thoughts on accepting these amendments as revisions to SB 197. I can be reached at (916) 322-0551.

Thank you in advance for your consideration.

#1) The duration of the protection of proceeds of sale is only six months. As written, however, the protection could be lost if payment is delayed through no fault of the debtor. For instance, the person who owes the funds may be insolvent, or the payment may be subject to some other litigation. To cure this:

- Now
page 4
lines 34, 35 ←
- On page 8, lines ~~21~~ and ~~22~~, delete "or become payable in an amount certain to"
 - On page 8, line ~~27~~, , after "date" add: "Proceeds shall be deemed received on the earliest date when the judgment debtor gains access to the full amount of the proceeds actually payable."
- Now
page 4
line 36 ←

#2) The intent of the drafters is clear that judgments for child, family and spousal support will have priority over the homestead. However, there is a drafting glitch. If there are other obligations for child, family or spousal support, the judgment debtor can apply to the court for an appropriate order. However, the statute is unclear about the court's powers. To cure this:

- Now
page 5
line 18 ←
- On page 8, line ~~8~~, after "exempt." insert: "If the court determines that all or part of the property is exempt, the court shall determine the extent to which the exempt property nevertheless shall be applied to the satisfaction of the judgment and of the other obligations for child, family or spousal support."

#3) The current draft requires court supervision of the proceeds of sale, and neither authorizes nor facilitates use of a private third party escrow to handle the details. The result is to inject the courts into transactions that are capable of being handled by the parties, if they are on speaking terms. To cure this:

- Now
page 5
line 25 ←
- On page 8, line ~~16~~, after "lien." insert: "Alternatively, all parties in interest may appoint a private escrow to administer the proceeds in accordance with this section, or as the parties may otherwise agree."

#4) The current draft establishes an inflexible limit on the time before which exempt proceeds must be reinvested in a principal dwelling in order to retain their exempt status. In some situations, the results will be grossly unfair to the debtor and his or her family. For instance, the purchase of a replacement home may fall through at the last minute; or a move from one locality to another may be frustrated by the bankruptcy of the debtor's prospective employer. To accommodate extraordinary situations, the court should have power to extend the six-month period. To cure this:

- Now
page 5
line 36 ←
- On page 8, line ~~27~~, after "judgment." insert: "On application of the judgment debtor, for good cause, the court may extend the six-month period for not more than six months; that and any subsequent orders extending time may be appropriately conditioned to take account of the legitimate interests of all parties in interest."